Tax Reform Study Committee

November 12, 2003
MACo Conference Room
2715 Skyview Drive, Helena, Montana

MINUTES

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file at the Department of Revenue. Exhibits for this meeting are available upon request.

COMMITTEE MEMBERS PRESENT

Jerry Driscoll
Ken Morrison
Myles Watts
Mary Whittinghill
Rep. Eileen Carney
Rep. Jill Cohenour
Rep. Bob Lake
Rep. Jim Peterson
Sen. Jon Ellingson
Sen. Gary Perry
Sen. Keith Bales
Sen. Dan Harrington

COMMITTEE MEMBERS EXCUSED

STAFF PRESENT

Larry Finch, Department of Revenue
Dan Dodds, Department of Revenue
Jackie Williams, Department of Revenue
Prudence Gildroy, Secretary

AGENDA & VISITORS

Agenda (ATTACHMENT #1)
Visitor's list (ATTACHMENT #2)

COMMITTEE ACTION

CALL TO ORDER AND ROLL CALL

The meeting was called to order by **Presiding Officer Senator Keith Bales** at 8:40 a.m. Secretary noted the roll.

The minutes of the previous meeting were approved. **Rep. Jill Cohenour's** name was misspelled on page 1.

Dave Ohler, Chief Legal Counsel, Montana Department of Revenue, presented an overview of Indian Taxation. He defined the terms "Indian" or "Native American" as an individual who descended from an Indian Native American. An enrolled tribal member is an Indian who is a member of a particular tribe. A tribe is a political organization similar to state government and each tribe is authorized to establish criteria for tribal membership. A reservation is a geographical area set aside for one or more Indian tribes. A non-Indian is an individual not descended from an Indian Native American. A non-member Indian would be an Indian who may or may not be an enrolled tribal member but is working on a reservation that is not his own. Fee land is property which is freely alienable. Trust land is land owned by the United States in trust for Indians and tribes. Legal incidence of tax was looking at the person who is responsible for paying the tax. A critical point in Indian taxation issues is who is responsible for paying the tax. That determines whether or not something can be taxed. The legal incidence in the motor fuels tax is on the motor fuels distributor unless the distributor is a Native American. Generally, an Indian not enrolled in a tribe who does not live on a reservation is treated the same for tax purposes as a non-Indian. An enrolled tribal member living and working on his own reservation is exempt from state taxation. Tribes are exempt from state taxation on their own reservation. Tribes and enrolled tribal members are not exempt from taxation off the reservation. While states are generally free to provide tax benefits to Indians, taxation of Indians is controlled principally by federal law. The law governing taxation of Indians is not static and there have been court decisions clarifying some of the issues.

Rep. Bob Lake asked if this includes all levels of taxation except for the fuel tax. **Mr. Ohler** replied the general principles hold true no matter what tax is being talked about. One exception to taxing tribes or tribal members on reservations has to do with real property. **Rep. Lake** asked if a tribal member gets a special discount. **Mr. Ohler** indicated the legal incidence of the fuel tax is on the distributor. If the distributor is the tribe they would likely be exempt. He knew of no current incidence of this. This issue came up in Oklahoma and the U.S. Supreme Court dealt with it. The legal incidence of the motor fuel tax was on the retailer and the tribe became a motor fuel retailer. The Court ruled they could not be taxed. The first step in analyzing these issues is where is the legal incidence and secondly, who is that person.

Sen. Bales asked if the tribe is the distributor can they distribute off the reservation as well as on the reservation and to non-tribal members as well as tribal members. **Mr. Ohler** clarified if the incidence of the tax is on the distributor, then it is likely they can sell the gas tax exempt.

Sen. Perry asked about non-members of tribes. He wondered why non-members would be exempt from tax simply because they purchase on a reservation or off the reservation as described to **Sen. Bales. Mr. Ohler** advised non-member Indians are not exempt from taxation. Only enrolled members of a tribe who are on their reservation receive tax exemptions. **Sen. Perry** asked if he as a non-Indian could go on a reservation and buy cigarettes and not pay state sales tax on those cigarettes. **Mr. Ohler** indicated he should be paying a sales tax on those cigarettes. An enrolled member of the Blackfeet Tribe on the Blackfeet Reservation would not have to pay sales tax. A non-Indian or a Crow Indian buying cigarettes on the Blackfeet Reservation is responsible for paying the tax. **Sen. Bales** thought the way the cigarette tax was working was everyone was paying the tax but the Tribes were getting money back from the Department. **Mr. Ohler** said that was correct, but he was presenting general legal principles. States and tribes can enter into cooperative agreements. The tribe agrees to tax its members and everybody that buys cigarettes on the reservation is taxed. The Department then gives the tribe back a portion of the cigarette tax money based on a formula. They have agreements with tribes on cigarettes, motor fuels and natural resources.

Jerry Driscoll inquired if tribes have to pay federal taxes. **Mr. Ohler** indicated yes, only state taxes are exempt. **Mr. Ohler** continued stating the legal incidence on the Montana Individual Income Tax is on individuals. Consequently Tribes and enrolled tribal members living and working on their own reservations are exempt. Enrolled tribal members living and working on another reservation are not exempt. A 1978 Montana Supreme Court case says Indians who are not members of the Tribe but are working on somebody else's reservation are exempt from state taxation. It is an old case and is based on older federal law. A case is working its way through the legal process and he thought eventually the Montana Supreme Court will be asked to take a look at this issue again. There has been some intervening federal law since 1978 that has made it fairly clear that a Crow living on the Blackfeet Reservation is not exempt from taxation. Enrolled tribal members living and working off the reservation are taxed. Enrolled tribal members living off the reservation but working on the reservation or vice versa are taxed.

Land that is held by the United States in trust for a tribe or an enrolled tribal member is exempt from property tax. **Sen. Bales** mentioned on BLM and forest lands the federal government does a payment in lieu of taxes. **Mr. Ohler** said there are some payments in lieu of taxes primarily keyed to schools. Some federal funds flow down to local government if there are tribal trust lands. Land held in fee by a tribe or an enrolled tribal member is taxable. This is one exception to the general rule. It is based on an old act of Congress passed in the first part of the century called the *General Allotment Act*. At one time it was the federal government's policy to try to assimilate Indians into American culture by giving them title to land. As part of the *General Allotment Act***,** Indians could obtain fee title to tracts of land on the reservation that had been federal land. Once the Indian obtained free title to the land, it was freely alienable. The courts have concluded that lands owned by the tribe or by tribal members that is alienable and can be sold can be taxed. Land owned by a non-tribal member or non-Indian is taxable on the reservations. With respect to personal property, property of a Tribe or an enrolled tribal member on the reservation is exempt. Property of an enrolled tribal member off the reservation is taxable. Property of a non-member Indian or non-Indian is taxable.

Rep. Bob Lake said on some reservations the Tribes are buying back land. The school system is still receiving state funds. The non-tribal property owners within that district are carrying the burden of the education system. **Mr. Ohler** said if tribal land is put in trust, it is taken off the tax rolls and is not taxable. Consequently, other people paying taxes would have to pay more. It was his understanding there are federal funds that can be rolled back to local governments if there are tribal trust lands located on the reservation. **Rep. Lake** said there are other agencies within the county that would use the property tax funds as well. He wondered if the payment in lieu of taxes is a direct payment to schools or to the county. He mentioned the previous testimony before the committee of a commissioner from Sanders County regarding tribal trust lands. He asked if this is something the state could negotiate with the federal government for reimbursement. **Mr. Ohler** didn't know the specifics of the payment. He had been involved with some discussions with the Blackfeet Tribe. They are looking at putting some of their fee land back into trust. Payments in lieu of taxes from the federal government can offset the loss of property taxes. He didn't know if it was negotiated or something in federal law.

Miles Watts said a payment in lieu of taxes is associated with the productivity of the land that is in the BLM. He didn't think the monies that come back to the schools are associated with anything having to do with loss of tax base. It was more associated with the number of students in the schools and those types of criteria. **Mr. Ohler** recalled the Tribe talked about the formula being the number of school children. He advised **Sarah Bonds, Indian Affairs Coordinator, Attorney General's Office,** might be able to answer the question. He offered to speak with her.

Rep. Cohenour advised that is Indian Impact Aid and is based on the students from the reservation attending the public school system. It is very specific and is similar to ANB funding. She wasn't sure about the county angle, but thought it was specific to the school systems. It goes through OPI like regular funding but to specific school districts.

(Tape 1 Side B)

Mr. Ohler addressed the sales tax. **Sen. Bales** asked if a non-tribal member owns a store if they collect the tax from everybody. **Mr. Ohler** advised they wouldn't collect the tax on enrolled tribal members because the incidence of the tax is on the purchaser, not on the retailer. **Sen. Bales** asked how that is different from the fuel tax. **Mr. Ohler** said the central question on all these is "Who are you taxing". The legislature gets to make that decision. With respect to the motor fuel tax, the legislature decided to tax the distributor. The distributor can pass on that tax to the retailer and purchaser. The analysis is whether or not the distributor is a tribal member or non-tribal member. The legal incidence of the sales tax is on the ultimate consumer. The analysis is whether the purchaser is a tribal member or non-tribal member.

Sen. Perry said since they would be discussing a sales tax at some point, he wondered what control would there be if the purchaser is on a reservation. He wondered how they would know if the sales tax was being paid or not and felt there would be a disincentive for the seller on a reservation. **Mr. Ohler** said those are mechanical issues, but the seller is responsible for forwarding the sales tax to the state and the seller has to account for it.

On a reservation tribal members have a card to present at time of purchase and then they are entitled to a tax exemption. A seller will need good records of the sales made to tribal members. He didn't think it was a huge concern.

Mr. Driscoll said if there is a general sales tax, could the tribe and the state negotiate a deal to tax everybody just like they did with fuel. **Mr. Ohler** said absolutely.

Ken Morrison asked if there is any case law on the issue of whether the state can force a retailer who is a member of the tribe or is the tribe to collect the tax. **Mr. Ohler** said the Supreme Court ruled Indian Tribes and Indian retailers have the minimal burden of collecting the tax, accounting for the tax and forwarding it. The forum used to force a retailer to collect and forward the tax is federal or state court. **Mr. Morrison** asked if the reason the state has gone to the negotiated agreements with the Tribes on the cigarette tax is to try to make the system work for both groups. **Mr. Ohler** said that is one of the reasons and another reason is the desire to try cooperative agreements instead of litigation. **Mr. Morrison** asked if it is reasonable to expect an agreement could be negotiated regarding a sales tax. **Mr. Ohler** thought it reasonably likely. The Salish-Kootenai tribe has a provision in their constitution that prohibits taxation of tribal members without their consent. There has to be a referendum and the tribal members have to agree to be taxed. They have been talking to the Flathead Tribe about the accommodations tax and that has been a sticking point. They have agreements with almost every other tribe in the state.

Rep. Peterson asked how consistent the revenue sharing agreements are from tribe to tribe. **Mr. Ohler** said the agreements are not identical but are fairly consistent per tax type. They have a cigarette agreement with the Crow, the Blackfeet and Fort Peck Tribes. They are pretty close but may not be exact.

Mr. Ohler addressed the Corporation License Tax. Corporations owned by a Tribe are exempt with respect to reservation income. Corporations owned by shareholders, some of whom are enrolled tribal members, are exempt with respect to reservation income. It is not clear how many enrolled tribal members have to be shareholders. The Supreme Court ruled if there are enrolled tribal members who are shareholders and the corporation does all of its business on the reservation it is exempt from the Corporation License Tax. Corporations owned by non-member Indians or non-Indians are taxable.

Rep. Lake asked about the Salish-Kootenai and if the profits from federal contracts are taxable to Montana. **Mr. Ohler** said he didn't know enough about what they are selling or whom they are selling to. **Rep. Lake** asked if they sell it to the government and it is assembled on the reservation, if Montana loses that tax. **Mr. Ohler** indicated yes. **Sen. Perry** thought there was an economic development loophole involved. There is high unemployment on the reservations and they are trying to attract business. If a manufacturing firm was to set up on the reservation and at least one shareholder was a tribal member, he wondered if that corporation would be exempt from corporate income tax. **Mr. Ohler** said it could well be. It is a fuzzy area because the Montana Supreme Court issued this opinion about two years ago and there has been no further development.

Flat Center Farms there was a farming operation that incorporated on the Fort Peck Reservation. One shareholder was a Native American. The land they farmed was trust land or land that was owned by enrolled tribal members on the reservation. Of the two shareholders, one was an enrolled member of the Fort Peck Tribe. The other was an Indian who was not a member of the Fort Peck Tribe. The Supreme Court ruled Flat Center Farms, Inc. was exempt from the Corporation License Tax. If there are ten shareholders and only one is an enrolled tribal member is an open question. Potentially there is some economic incentive for corporations to operate on the reservation and have shareholders who are enrolled tribal members, etc. **Rep. Lake** asked how much is covered by federal law and how much is controlled by the legislature. **Mr. Ohler** said one of the general principles is "while states are free to provide tax benefits to Indians, taxation of Indians is governed by federal law." It is primarily the prerogative of Congress as to whether states can or cannot tax tribes.

Sen. Dan Harrington asked about gaming on the reservation. He wondered if the tribes keep the money. **Mr. Ohler** said he didn't know. **Mr. Driscoll** advised the state can't tax Indian gambling. The federal law says if the state allows gambling there has to be a treaty with the tribe. If the tribe was to tax gambling, they would get all the money and the state gets nothing. **Mr. Harrington** asked if the federal law controls that. **Mr. Driscoll** said if Montana allows legal gambling the tribes automatically get it. Montana could negotiate the number of machines and payouts. **Mr. Harrington** said the argument in California was how much power the state has to tax. **Mr. Driscoll** reported Indians said the state could not tax. **Mr. Ohler** said Congress has the authority to determine these issues. Congress chose to pass legislation dealing with the issue of Indian gambling because they thought it needed to be regulated. **Mr. Driscoll** indicated Minnesota does not allow gambling except by Indians but that was passed by the legislature. To get it passed the Indians said they would pay taxes on it. Every state is different. In Connecticut there is a casino night for charities with wide open gambling. The reservation in Connecticut challenged that and they won. That's how they got gambling on the reservation. **Mr. Ohler** offered to get more information for the committee.

Sen. Bales asked for public comment regarding taxation of tribes and tribal members. **Toby McAdam** commented there are some issues of legality. The state can withhold money for cities and towns on reservations. The state has the option to negotiate. The fuel tax collections have gone down over the last few years. If distributors on the reservation are selling off the reservation, he wondered if that is what is causing the amount to go down. The number of vehicles licensed every year goes up, but the amount of fuel tax collected is going down.

Mr. Finch advised the next item would be the General Overview of State and Local Government Revenues and Expenditures. *(See supporting documents)* This is the information the subcommittee has been working on. Staff met with the subcommittee twice.

Dan Dodds, Department of Revenue, explained a chart which showed total personal income for the United States, for Montana, and for surrounding states. Income was shown for the years 1980, 1990 and 2000. For the United States as a whole, personal income grew by 263% from 1980 to 1990. Idaho grew 277%, Montana 188% and Wyoming was about 148%. In the two decades that made up that period, growth wasn't steady in the states. In Idaho in the 1980s, the growth in personal income was about 50% and in 1990 was about 150%. The chart showed total personal income in current dollars earned by everyone in the state. One factor is population growth. Another component is inflation. ***(Tape 2, Side A)*** **Mr. Dodds** continued that the US population grew by 24%. Idaho grew by 37%, Montana by 14.4% and North Dakota lost population over this twenty -year period. Population growth was faster at the national level and for all of the states in the 1990s. In the 1980s Wyoming and North Dakota lost population and Montana and South Dakota had small population growth. Montana's population growth in the 1990s was just slightly below the national average and Idaho's was well above. The other states were below the national average. Real personal income per capita, income per person adjusted for inflation, increased 40% for the national average for the twenty -year period. Montana was second from the bottom and in North and South Dakota real income per person grew faster than the national average over the twenty years. The other states were slower.

Rep. Eileen Carney asked **Mr. Dodds** to explain total personal income and the total percent of total personal income per capita. **Mr. Dodds** replied the total personal income divided by population gives the total income per capita. **Rep. Carney** asked where the total personal income comes from. **Mr. Dodds** indicated it is estimated by the Bureau of Economic Analysis of the Department of Commerce. **Mr. Finch** explained total personal income does not include capital gains income.

Sen. Jon Ellingson asked if it includes any unearned income. **Mr. Dodds** stated it does include other income that would be called unearned income. **Sen. Ellingson** stated the only form of income that is not included in personal income is capital gains and **Mr. Dodds** replied yes.

Mr. Dodds explained charts that showed revenue for state and local government combined in Montana over the same twenty- year period. He defined each category of revenue. Federal transfers included any unit of state and local government including schools, etc. Current charges included tuition, fees, etc. Miscellaneous general revenue included assessments, etc. He explained that non-general revenue is primarily gross revenue from government enterprises such as liquor sales. This is not revenue that is generally available to fund general government operations. In other states a large component of this is sales by government-owned electric or natural gas utilities. There are a number of states with state utilities, local utilities, or public utility districts that have significant utility sales. In most cases, those publicly owned utilities mostly break even year after year. Another component is contributions to public employee retirement funds, unemployment insurance, etc., and investment earnings on those trust funds. The chart showed total revenue, revenue per capita and revenue per $1000 of personal income. From 1980 to 1990 the economy grew faster than federal transfers to state and local governments. From 1990 to 2000 the transfers from the federal government grew faster than the economy.

Mr. Dodds explained a chart that showed more detail of total Montana state and local general revenue from own sources. In 1980 taxes were 74%, 66% in 1990 and 60% in 2000. Current charges and miscellaneous general revenue increased over the period.

Mr. Driscoll asked if the premium paid to the state Workers Comp fund was in the current charges. **Mr. Dodds** indicated that was in the non-general revenue line on the previous page. **Mr. Morrison** asked what caused the significant increase in current charges between 1990 and 2000. **Mr. Dodds** answered it is largely tuition increases in the University system. **Mr. Watts** asked about the 50% increase in the miscellaneous general revenue. **Mr. Dodds** replied it includes the lottery and interest earnings. The balance in the coal trust is a lot larger.

Mr. Dodds explained state and local taxes. Selective sales included motor fuel taxes, cigarette and tobacco taxes, accommodations tax and other non-general sales taxes. **Mr. Watts** asked if it includes alcohol and **Mr. Dodds** indicated yes. **Sen. Ellingson** asked about the rationale for removing capital gains from inclusion in personal income. He asked if they were comparing apples to apples in every instance. **Mr. Dodds** advised personal income is based on current production and current income from that production. Capital gains are income from holding an asset over a period of time and are not attributable to productive activity in the current year. Wages and salaries are measured as income earned for labor services during the current year. Capital gains are not attributable to a specific year. **Sen. Ellingson** asked, when comparing the Montana average with the U.S. average and the average of surrounding states, if capital gains has been excluded. **Mr. Finch** advised there is no capital gains income in the definition of personal income. That is decided by the U.S. Department of Commerce. Income taxes include taxes on the capital gains portion of income reported on income tax returns, but are not in any of the income definitions. **Sen. Ellingson** said that points up the anomaly. There are taxes assessed to it, but the total tax burden is being compared based on something that is smaller than the actual income on which the taxes are assessed. His concern was with consistency. **Mr. Dodds** thought it more useful to look at personal income as a measure of the size of the state economy rather than as what could be taxed.

Rep. Carney asked about the revenue per $1000 of personal income in 1980 and if that was in 1980 dollars. **Mr. Dodds** said that would be true either with inflation in or inflation out. This could be looked at in real terms with inflation taken out. **Sen. Bales** asked if that is an actual figure. **Mr. Dodds** replied it is taxes divided by personal income. Both of those have inflation in them. The inflation part could be cancelled out and still get the same ratio. **Mr. Finch** indicated it is the charge of the committee to look at Montana's tax structure. In 1980 Montana collected $786 million in state and local taxes. In 2000, the state collected $2.1 billion in taxes. In 1980 taxes in Montana consumed $109 out of every $1000 of personal income. By 2000 that figure dropped to $103 per every $1000 of personal income. As a share of the economy, taxes actually declined from 1980 to 2000. **Mr. Dodds** advised individual and corporate income tax was 23% of tax revenue in 1980 and by 2000 it was 29%. Severance taxes have gone down per $1000 of personal income but there is very little change from 1980 to 1990 and it is down to $85 per $1000 by 2000. There has been a small reduction in taxes from this sector but the economy as a whole and taxes on the rest of the economy have grown while that source has been stable.

Sen. Perry asked if the reduction in the severance tax over those twenty years is due to a reduction in products to be taxed. **Mr. Dodds** advised this is a combination of all taxes on mineral production including the coal severance tax and the metal mines license tax. It also includes the taxes that are paid on mineral production instead of property taxes on the mines. It is a combination of changes in production and changes in tax rates over this period. There has been a fairly stable coal production over the last few years and declining production in metal mines. **Mr. Finch** pointed out the coal severance tax in 1980 was 30%. There may still be the same amount of production going on but the tax rate has been cut in half. There may be declines in production in certain areas that contribute to that too. There will be declines in metal mines production over the next couple of years as some gold mines close in Montana. **Sen. Bales** asked when the coal tax was reduced and was told in 1989. He was surprised there was not a bigger drop. ***(Tape 2 Side B)*** **Mr. Finch** didn't think coal was necessarily half of it. A lot of this would depend on oil and natural gas production taxes in Montana, which are fairly large. This would also include gas and minerals, micaceous mines, miscellaneous mines and virtually all severance tax activity. Other things that come into play include not only the amount of gas and oil being produced but also the value of oil and gas over time. Severance taxes are based on value of production and total production times the price. As both production amounts and prices change over time the whole natural resource sector can fluctuate up and down fairly wildly. The chart looks at single points in time. **Mr. Finch** advised in terms of the overall economy the drop in 1980 to $13 out of every $1000 down to $4 out of every $1000 in 2000 is less than 1/3 of where that tax type's contribution was in 1980 per $1000. **Sen. Perry** said he was trying to coordinate this table and figure 3 with information from the Department of Revenue from January of 2003. **Mr. Finch** stated these are not comparable and **Sen. Perry** asked why. **Mr. Dodds** advised they are not exactly equivalent. The biggest difference is the other information was just state revenue and not local. **Sen. Perry** indicated it said Montana state and local taxes in 1984. He wondered why the tables were not congruent. **Mr. Dodds** explained the categories are not the same. The subcommittee wanted a uniform set of categories for comparing Montana to other states, which was provided by the Census Bureau. The other chart was something he put together during the legislative session and he lumped taxes and revenue together in a different way.

Rep. Peterson thought the chart **Sen. Perry** had was a chart prepared by **Mr. Dodds** at **Rep. Peterson's** request. They were trying to compare some taxes over time. He didn't think the older charts that were prepared at the request of individuals are comparable because the baselines are different. **Mr. Finch** indicated it depends on what the information is used for. During legislative sessions they might be asked by the Chairman of the Taxation Committee to compare severance taxes with income taxes and selective sales taxes over a time period. It wouldn't include property taxes or other taxes. Severance taxes when comparing those three taxes is going to be a larger share of the pie. It depends on what comparisons are being asked for over time. The current charts are a fundamental set of numbers worked on by the subcommittee and are all-inclusive and broad. This cannot be compared with other special looks. **Mr. Dodds** recalled the January request was for taxes paid by particular industries. Property taxes paid by natural resource industries are included in part of the pie labeled natural resources. In the current chart they are called property taxes. **Sen. Perry** commented about the importance of accuracy and consistency when talking to constituents. **Rep. Peterson** thought that was precisely what they were attempting to do with the new set of charts. He requested establishing a common baseline to avoid what **Sen. Perry** pointed out. **Mr. Dodds** said the reason the charts are based on data from the Census Bureau is data was collected and put into consistent categories over time and across states. When comparing data for Montana compared to another state it can be assured the data has been put into a uniform set of categories.

Mr. Dodds described the total state and local revenue in FY 2000, for Montana, the average of all states and the average of surrounding states. The table showed revenue per capita and per $1000 of personal income. Total state and local revenue per $1000 of personal income for Montana was $272, the US average was $231 and the average of surrounding states was $260. Montana is receiving $63 in federal transfers. Montana is one of the larger recipients of federal dollars and that is driven by highway funds. Regarding taxes as a category there is not a lot of difference between Montana, the US average and the average of surrounding states. Current charges for Montana were higher than the country as a whole and so are the surrounding states. Miscellaneous general revenue is higher for Montana than the country as a whole and the surrounding states. He distributed tables that showed the total dollar amounts for Montana, surrounding states and all states. He pointed out an error on the table—the Wyoming number in the non-general revenue should be $900 million instead of $3.5 billion. The subcommittee had asked previously why this number was so large. Wyoming indicated it was wrong. **Mr. Finch** advised it was an error in the census data. **Mr. Dodds** indicated the pie charts are correct but it didn't get corrected in the table.

Sen. Ellingson asked why Montana has so much more miscellaneous general revenue than surrounding states. **Mr. Dodds** said part of it is revenue from state lands. Montana has more mineral production on state lands than Idaho and the Dakotas. Another part of it is interest earnings on the coal trust. Idaho and Wyoming have nothing comparable.

Sen. Perry said if the Wyoming correction changes the total by that amount and **Mr. Dodds** indicated yes. **Mr. Dodds** said they would get the committee a corrected table.

Mr. Dodds addressed state and local taxes in FY2000 in Montana compared to all states and the four surrounding states combined. In Montana property taxes were 43% of tax revenue, all states were 28% and surrounding states were 30%. The general sales tax for all states combined was 25% of revenue and for surrounding states was 27%. Income taxes for Montana were 29% of revenue for Montana, 28% for all states and 17% for surrounding states.

Sen. Harrington asked about the pie charts. **Mr. Dodds** indicated the combined pie charts were a little misleading but sidebars were provided for each of the states separately. When they were lumped together they look close to the national average but the surrounding states were different from each other. **Mr. Finch** advised the 17% for surrounding states was because neither South Dakota nor Wyoming have income tax.

Rep. Lake asked if the numbers include revenue from local option sales taxes. **Mr. Dodds** indicated yes. **Rep. Lake** asked if the property tax in surrounding states goes to general fund or to local governments. **Mr. Finch** stated a spreadsheet for the **Property Tax Reappraisal Study Committee** shows total sales taxes collected and total property taxes collected by state with the amount of the property tax that is going to state government and the amount that is just for local government purposes. He offered to get that spreadsheet for the committee. **Mr. Dodds** asked if **Rep. Peterson** was also asking about local option sales taxes. **Rep. Peterson** asked if that is part of the spreadsheet. **Mr. Finch** indicated it is not broken out. **Rep. Peterson** requested a breakout of the local option sales tax that goes to local services. **Mr. Finch** thought they could provide that by the next meeting.

Mr. Dodds compared actual Montana state revenue in FY2000 with what it would have been if SB 407 had been in effect that year. Selected sales taxes would have gone up from 16% of tax revenue to 18%. This category includes all of the additional taxes in SB 407—the sales tax on accommodations and rental cars and the tax increase on cigarettes. Income taxes would have gone down from 29% total tax collections to 27%. Revenue per $1000 of personal income would have gone up from $16.67 to almost $19.

Sen. Bales advised part of SB 407 is a capital gains reduction but that isn't included. **Mr. Finch** replied capital gains are reflected in the individual income tax. **Sen. Bales** inquired if capital gains were not in the original charts. **Mr. Finch** said capital gains are not included in the definition of total personal income. Capital gains taxes are in all the tax figures.

Sen. Ellingson assumed they haven't included the 1% and 2% credit on capital gains tax in the outlying years. **Mr. Finch** said what this reflects is the impact of SB 407 when it is fully phased in. ***(Tape 3, Side A)***

Mr. Morrison asked if Idaho has close to a balanced three-legged stool. **Mr. Dodds** advised in terms of equal reliance on those three tax types that is probably true. North Dakota is probably next and some of the others are pretty unbalanced. **Mr. Morrison** commented North Dakota seems to rely heavily on the consumption tax. **Ms. Whittinghill** asked if it could be determined what is driving the miscellaneous general revenue such as special improvement districts, etc., versus the coal tax. **Mr. Dodds** indicated yes.

- Break 10:40 a.m. -
- Reconvene 10:55 a.m. -

Rep. Peterson expressed appreciation to **Mr. Finch** and **Mr. Dodds** for their work with the subcommittee. He found the information extremely valuable and it helps bring things into perspective with a common baseline.

Jim Standaert, Legislative Fiscal Division, handed out a chart of the expenditure categories and a chart of total expenditures by state and local governments corresponding to the same broad categories presented on the revenue side. A glossary was included. He explained charts of Montana for 1980, 1990 and 2000, and charts tracking spending by the state and local governments in Montana versus the four surrounding states versus all the states. The first chart showed a very small amount paid to the federal government. Salaries and wages have declined from 37% in 1980 to 34% in 1990 and 32% in 2000. This could reflect the state is doing more contracting or becoming more efficient. Other current operations increased indicating more contracting. Assistance and subsidies and capital outlay have declined. Interest on debt has increased and insurance benefits and repayments have decreased.

Sen. Bales asked about assistance and subsidies being less than 1% of total expenditures. **Mr. Standaert** indicated a lot of welfare assistance is for salaries and wages of people that run the agencies. That would be included in the salaries and wages. **Sen. Bales** thought it seemed small since a big portion of the general fund budget is health and human services. **Mr. Morrison** asked if it could be included in other current operations—contracts with people who disperse the funds. **Sen. Bales** thought Medicaid may go into something different. **Sen. Perry** said there is a 15% increase in other current operations. There are some non-profit corporations that do services for the state and he wondered if it is included in that category. **Mr. Standaert** said to the extent they are contracted it would be other current operations. If it is a function that is no longer done by the government but the private market comes in and does it, it won't be included. **Sen. Perry** wondered if there has been a trend away from direct governmental services to channel funds to non-profit organizations for delivery of services. **Mr. Driscoll** asked if Workers Comp and Unemployment were included. **Mr. Standaert** advised they are spread all over or in insurance benefits.

Sen. Ellingson referred to figure 1. There is a difference of a couple hundred million dollars between this chart and **Mr. Dodds** chart for FY 1980. **Mr. Dodds** said one area that is not going to match any particular year is the unemployment insurance and employee retirement. Contributions to those systems and interest earnings in the trust funds are counted in the revenue. Payouts from those are shown in **Mr. Standaert's** chart. **Sen. Ellingson** said if that were one of the categories, the state is taking in more money in contributions to the retirement system than is being paid out. He asked if there are other categories of expenditures and income, which have a similar difference. **Mr. Dodds** thought that was where a large part of the difference came from.

Sen. Bales asked **Mr. Standaert** to find out about health and human services. **Rep. Peterson** asked if it is possible the difference is also the fact that some taxes collected go into something like the coal severance tax fund. That goes into the trust and is paid out only in the form of interest. **Mr. Morrison** said there might be owner's equity. **Mr.**

Driscoll asked if interest and dividends on the pension fund would be included in the $5.6 million as income or just contributions. **Mr. Dodds** said what is counted as income on the pension fund is the employee contribution not the state's contribution as an employer. That is considered a transfer of funds within the state government. **Mr. Driscoll** asked if dividends and interest earned on those trust funds is counted. **Mr. Dodds** indicated yes.

Mr. Standaert referred to the second chart. The chart showed that more is being spent on direct general expense-capital outlay than in 1980. His third chart showed total state and local direct general expenditure in Montana by function. Spending on higher education grew from 7% in 1980-1990 to 11% in 2000. Public school spending declined from 32% of total state and local spending to 31% in 1990 to 25% in 2000. Social Services and Income Maintenance increased from 14% in 1980 to 18% in 1990 to 20% in 2000. Transportation declined from 19% to 12%. Public Safety was 6% in 1980, 5% in 1990 and 7% in 2000. Environment, Housing, Natural Resources and Parks went from 7% in 1980 to 8% in 1990 and 9% in 2000. Government Administration Interest on Debt and Other went from 15% in 1980 to 18% in 1990 to 16% in 2000.

Sen. Harrington asked about the amount to higher education and if that was due to increased tuition. **Mr. Standaert** advised grants and contracts have increased. **Sen. Harrington** commented 1992 was the first year they passed contracts. **Mr. Standaert** said even though it came to the general fund in 1990, it would still be counted as university system money. **Sen. Perry** said on the definition sheet it says environment, natural resources and parks and on figure 3 it is listed as environment, housing, natural resources and parks. He asked about the housing. **Mr. Standaert** said it was an oversight. Housing is whatever housing services are provided. **Mr. Driscoll** asked if that includes the Board of Housing loan program. He wondered where the income portion would show. **Mr. Standaert** said the money is brought in from the bond and the money is spent to purchase housing. It would be an expenditure of funds even though it is loan. **Mr. Standaert** explained the next three charts comparing spending in Montana with the surrounding states and all states. There is a lot less difference in the spending patterns in Montana versus the four state regions and the rest of the country than is seen on the revenue side. This is driven by the demand for government services. ***(Tape 3, Side B)*** He noted it is hard to tie a revenue source to spending. Money spent out of the general fund is hard to tie to a particular revenue source.

Mr. Dodds explained a spreadsheet of projected sales tax revenue at a rate of 1%. The spreadsheet included a broad list of categories that could be taxed. It is likely some things within each category would be exempt in a sales tax bill. There might also be some items that cross categories that wouldn't be taxed. There was an option to pick the tax rate, which would automatically recalculate revenue. The spreadsheet does not include sales for resale. In other states that have the sales tax, sales for resale are not taxable. It also didn't include sales to federal agencies or Indian tribes which states can't tax. Nothing was taken out for cost of administering the tax and the spreadsheet assumes full compliance. When he prepared fiscal notes for the bill in the last session he assumed 95% compliance. In the first category, a significant percentage of sales are to businesses.

Some states try not to tax sales to businesses, but some specifically go after those sales. A footnote denoted those sectors where that is significant. A broad exemption of sales to businesses would require recalculating.

Rep. Lake asked where to find the descriptions on the footnotes. **Mr. Dodds** indicated they are in one of the handouts from the first meeting. **Mr. Dodds** continued to explain categories where a selective sales tax already exists were flagged. Those categories included cigarettes and the retail telecommunications tax. Most sales to contractors are things that are going to be incorporated in a construction project, which is then going to be sold. There are a few states where the final sale of a building or other construction projects is subject to the sales tax. In most of those states they chose not to tax sales to contractors. Sales to a contractor in those states are considered a sale for resale, and the contractor is given a non-taxable transaction certificate. Sellers keep track of which of their sales are taxable and which are not. In some other states, contractor's purchases are taxable but the sale of the final construction project is not taxable. The materials are taxed but not the labor. Taxing construction can be either taxing the sale of a construction project, taxing sales to contractors but not the final construction sale or exempting those sectors as a whole. One of the footnotes related to categories most other states don't tax. Most states don't impose a sales tax on health care. Services were once a much smaller part of the economy and it was thought taxing services would be difficult in terms of compliance and enforcement compared to taxing tangible personal property. Many states chose not to tax services. He advised that when he does a fiscal note, the numbers come out lower. Within each category some sales are likely to be exempted. No vendor allowance has been taken out. The spreadsheet should be looked at as tax liability rather than net revenue to the state. In reply to a question by **Mr. Standaert**, he indicated the data behind the spreadsheet is based on data from the economic census from 1997. Every five years a census is done of businesses. 1997 was the last available data. Sales in every category have grown at 3.1% a year since 1997. Another area where the numbers are soft are where areas of the economy are growing faster or slower than the economy as a whole.

Sen. Perry asked him to explain compliance and vendor allowance. **Mr. Dodds** said the spreadsheet assumes everyone who owes tax is paying tax, people are not misusing the non-taxable transaction certificate and there is no problem with merchants not collecting tax. There have been studies on compliance on sales taxes in other states and it is generally pretty good. It is better than compliance with the income tax. The biggest problem is businesses getting a non-taxable transaction certificate for their wholesale purchases and then using it for more than they are legally allowed to use it for. The other problem is sales across state borders. In general the tax should be paid to the state where the sale is being made but that doesn't always happen. In about half of the states that have a sales tax, merchants are allowed to keep a small percentage of collections as compensation for their costs of collecting the tax. **Sen. Perry** asked about the category of furniture sold to contractors. He asked if there would be documentation that the contractor had an obligation to collect sales tax from the purchaser on that furniture as opposed to including it in the cost of the home. **Mr. Dodds** advised any merchant in a sales tax state is required to track all sales whether taxable or non-taxable. For audit purposes, they need to track non-taxable sales. They will have documentation to show this was a non-taxable sale. The non-taxable transaction certificate gives the means of tracking that. Those are issued generally to businesses and are also issued to non-profits.

(Tape 4, Side A)
Rep. Cohenour said if the purchase of a house was taxed, the bank might have to collect that and remit it to the state. It wouldn't have to be collected by the contractor. **Mr. Dodds** said he was not sure how that transaction was handled mechanically in other states. In general the sales tax is added to the purchase price and the purchaser pays that to the seller who is responsible for remitting it to the state.

Sen. Ellingson asked if the general rule of most states that have a sales tax is if a resident goes out of state and purchases something the resident is supposed to be paying sales tax on the item they bought out of state. **Mr. Dodds** replied that is the general rule. Other states have a sales and use tax. The sales tax applies to transactions in the state and the use tax applies to the use of goods that were bought in some way where the sales tax wasn't paid. For internet or mail order purchases the buyer owes tax and the seller may or may not have an obligation to collect the tax. If the seller has a presence in the state, such as Sears, they have an obligation to collect the tax. If a purchase is made from an internet company who has no presence in the state, they probably don't have a legal obligation to collect the tax. **Sen. Ellingson** asked even if Montana stated they had an obligation if it is a jurisdictional question. **Mr. Dodds** advised the U.S. Supreme Court ruled the seller has to have an economic presence in the state. It is not necessarily having a physical location in the state, but there have been cases where an out-of-state seller taking phone orders and shipping into the state with no other presence in the state does not have an obligation to collect the tax. **Sen. Ellingson** asked which categories have the most internet sales and where those internet sales are going. His impression was internet sales are increasing. **Mr. Dodds** indicated it was not in this data, but it was possible to get data on that issue. A lot of those sales are being made by companies with an economic presence and they are obligated to collect the tax. A national company that has an economic presence in 2/3 of the states will find it easier to collect tax in every state. **Mr. Finch** clarified just because a company doesn't have a legal obligation to collect the tax doesn't mean the liability has gone away. The obligation to pay the tax is still there statutorily. There is leakage in the compensating use tax part of the sales tax. A lot of states try to capture that by either having people voluntarily pay their use tax on purchases from out of state on their income tax form or by auditing businesses. Health care equipment is taxed in the state of Idaho and there is an obligation to pay the compensating use tax on those purchases irrespective of whether the company they bought it from voluntarily agreed to collect the tax. **Sen. Ellingson** thought for most consumers who buy something from out of state that isn't subject to a sales tax, 95% of them would not volunteer that information on their income tax returns. He thought 90% of them wouldn't even know they had the obligation. **Mr. Standaert** indicated a car has to be registered. **Sen. Bales** asked about interstate agreements for distribution of tax between states that have sales taxes. **Mr. Finch** indicated there are some agreements between states in the case of the compensating use tax. If a dentist purchases equipment from out of state and that equipment is taxable, states will have agreements for the purchaser to get a credit in Montana. He thought Washington and Idaho have agreements with some states. If a Montanan shows their driver's license in Washington they don't have to pay the Washington sales tax. He thought there is a lot of slippage in those types of agreements. **Mr. Watts** asked about the unified sales tax agreement. **Mr. Finch** said it was the streamlined sales tax. **Mr. Dodds** explained because of this issue, sales tax states worked out an agreement. A Supreme Court case called *Quill v. North Dakota* said if a company has no economic presence in the state the state can't require an out-of-state company to collect sales tax because the myriad of different sales taxes and local option taxes with different rates and bases places an undue burden on interstate commerce. The Supreme Court said Congress has the authority to give states that authority. The sales tax states hoped if they made their sales tax laws more uniform and lowered compliance costs they could convince Congress to give them that authority. The streamlined sales tax agreement has common definitions for categories. The agreement doesn't require states all tax the same things, but it does require they all define them the same way. The agreement has mechanisms to try to reduce some of the other complexities interstate sellers face. It requires states to set up a computer system that will giver sellers the tax rate. The sales tax states hope to eventually convince Congress to give them the authority to require out-of-state sellers to collect the tax. The states signed the agreement at the end of 2001 and are still working on implementing it.

- Break 12:10 p.m. -
- Reconvene 1: 25 p.m.-

Mr. Finch and **Sen. Bales** discussed the agenda for the afternoon. **Mr. Finch** indicated they would start with a comparison of the **MACo** tax reform bill from 1997 with the **Peterson** and **Mangan** tax reform bills from 2003. The comparison was by both **Mr. Finch** and **Mr. Dodds**. One document looked at all the components of the bill that were affected other than the sales tax and another document looked at the sales tax piece of those bills. The **MACo** reform bill did not reform income taxes in any way but was focused on reforming the property tax structure. It revamped which monies would be funding what expenditures. SB 470 would have reformed the Individual Income Tax by changing the current law 10-tier tax rate table with rates that range from 2% to 11% to a 7-tier table with rates that ranged from 1% to 6.9%. It would have capped the then current law limited deduction for federal income taxes paid during the year to $6000 or $12,000 for married couples, and would have provided for a non-refundable credit against individual income tax of 2% of net capital gains income. **Sen. Bales** asked if this was the bill that passed the Senate or the one that was introduced. **Mr. Finch** said the items reflect the last version of the bill that was in the Legislature. The Legislature passed a tax reform package in the form of SB 407 that did what was proposed in **Sen. Mangan's** bill. SB 407 reduced rates from 2 to 11% down to 1 to 6.9% and capped the deduction for federal taxes at $5000 and $10,000 and provided for an eventual 2% capital gains tax credit. **Rep. Peterson's** bill eliminated the progressive rate structure in its entirety and opted to go with a single flat rate of 5.75% applied to all taxable income. It also provided an exclusion from income of 50% of capital gains income, which is similar to what the federal treatment of capital gains income used to be. The federal government used to exclude 60% of capital gains income from taxation as a means of hedging capital gains against inflation. To protect the lower income end of the scale, **Rep. Peterson's** proposal would have increased the personal exemption for taxpayers, spouses and dependent children from $1840 to $5740 beginning in tax year 2004. It would have eliminated entirely the deduction of federal income taxes paid during the tax year.

Ms. Whittinghill asked about the top income level in the **Mangan** bill and if it was higher. **Mr. Finch** recalled all the proposals were very close. To offset the perceived regressivity of a sales tax, both of these bills incorporated a sales tax credit people could take against their individual income taxes. Usually sales tax credits, in order for them to be effective, are refundable credits. A refundable tax credit means a taxpayer qualifies for a certain dollar amount of credit and if the tax liability isn't as big as the credit, the state will send a check equal to the difference between the amount of credit qualified for and the tax liability. If the credit is non-refundable, the credit can be taken up to the amount of the liability but the taxpayer doesn't get anything back after that. The **MACo** bill provided a dollar amount of credit based on the number of people in a house that qualified for an exemption under personal income tax. SB 470 had a similar concept and in both cases the credits get phased out above certain income levels. In SB 258 it was phased out for household incomes above $23,000. In SB 470 it was phased out for households with more than $35,000. In SB 470 it was a household income credit irrespective of the number of people living in the household. Everyone with household income of $50,000 was entitled to a $200 credit against sales taxes irrespective of the population in the household. The final version of HB 749 did not have a sales tax credit, but **Rep. Peterson** was working with the department on one. Most of the effort in the **MACo** bill (SB 258) were directed to property tax reform. SB 258 would have significantly reformed Montana's property tax system. Currently the property tax system in Montana is based on classifications of property with 11 different classes with their own taxable evaluation rates. The **MACo** bill would have eliminated that classification system entirely. Everything would be valued at 100% of market value and everything would be taxed at 100% of market value with no classification differences whatsoever. Mill levies would have dropped considerably and the system would have been simplified. Most personal property would have been exempted from taxation. Business equipment would have been exempted. It redefined some property as real property. It exempted livestock from taxation and provided for a homestead exemption for residential properties equal to 65% of the first $50,000 of the market value of residential property—a maximum of $32,500. The bill would have eliminated the 6% university mill levy etc. ***(Tape 4 Side B)*** Schools would have been allowed to levy mills to fund the over-base portion of the district's maximum general fund budget. It re-defined the market value terms for certain property types. Mine net proceeds would have been taxed at 14 times the annual net proceeds and mines gross proceeds would have been taxed at 100% of gross proceeds. These are technical adjustments that were done to keep the entire system in sync with the general notion of taxing everything at 100% of its full market value. Agricultural land and forestland were taxed at 100% of productive capacity. 20-160 acres of land would have been taxed at 7 times the productive capacity of grazing land at the average grade. The bill would have repealed the rail car tax, the property tax assistance program and reimbursements to local governments under HB 20 and SB 417. SB 470 would have provided a refundable credit against individual income tax equal to the property tax associated with the 101 university and school equalization mills. The credit was capped at $20,000. Businesses would have been allowed the same credit against their corporation license tax equal to the property taxes they paid associated with the 101 mills up to a maximum of $20,000. HB 749 was similar to SB 470 with the major exception that there was no cap on the amount of credit.

In answer to a question from **Rep. Peterson, Mr. Finch** reminded the committee of the trigger for personal property tax to phase out from 3% to zero. SB 470 repealed that mechanism but HB 749 kept the phase out in place. All three bills would have had the state fund the base budgets of all schools in the state with sales tax revenue, leaving the property tax to local governments. The state would assume responsibility for equalization of state funding of schools. In SB 258, school retirement and transportation schedule amounts would have been funded 100% with sales tax. SB 470 would have eliminated the HB 124 block grants to schools as they would not be necessary with the state funding of the base budget of schools. HB 749 had the same treatment for school finance as SB 470. The corporation license tax was not addressed in either SB 258 or SB 470. HB 749 provided for an exclusion of 50% of capital gains income for corporation license tax purposes. Regarding natural resource taxation, SB 258 would have changed the distribution of oil and gas production tax revenue by basing it on current fiscal year mills as opposed to continuing an allocation that had been fixed on mills levied back in FY 1990. SB 470 would have removed statewide mill levies from the non-levied revenue distribution formula associated with oil and gas production. That money would have no longer come to the state general fund and would have been available for distribution for local governments. SB 258 addressed motor vehicle taxation issues and increased the telephone company license tax rate. These were addressed in subsequent legislation. All of the bills contained either voter approval or contingent termination. SB 258 and SB 470 provided the bill be submitted to the voters. HB 749 did not require a submission to the electorate but provided for contingent termination on December 31, 2009 unless the legislature referred a measure extending the sales and use tax laws to the electors at the November 2008 general election and the electors approved the measure.

Mr. Dodds compared the general sales tax provisions of the three bills. Most of the language in the bills is the same. The bills are written in a way that sales are presumed to be taxable unless they are exempted. Exemptions include goods and services, buyers whose purchases are exempted and sellers whose sales are exempted. All three bills tax sales of tangible personal property, and sales of services. All contain a use tax component for taxing the use of tangible personal property or services where tax was not paid on the purchase. None of these bills tax sales of real estate or sales of businesses. All three bills had a 4% tax rate. When comparing exempt goods and services in the bills, all three bills contained provisions exempting wholesale sales. SB 258 and SB 470 contain additional language relating to architectural, engineering and related services being supplied to an out-of-state buyer. Regarding interstate commerce, most of the language in the bills deals with complying with federal constitutional issues. States can’t tax interstate commerce but can tax goods and services that have gone through interstate commerce. Most of the language in the bills deals with exempting types of sales that are exempted by the federal preemption. SB 258 contained language giving a specific exemption for intrastate transportation. All three bills exempt health services. Education services are exempted in SB 470 and HB 749. Agriculture, forestry and fishing and hunting services are exempted in all three bills. SB 258 exempted only agricultural services. SB 470 and HB 749 exempted radio and television broadcasting and SB 258 did not. SB 470 and SB 258 provided an exemption for pipeline transportation and HB 749 did not. A lot of pipeline transportation is interstate commerce, which is exempted because of that. What would be taxed under HB 749 would be some of the strictly intrastate natural gas and petroleum gathering systems. SB 258 and HB 749 did not have specific exemptions for farm product warehousing and storage and SB 470 had that exemption. SB 258 and SB 470 had specific exemptions for security brokerage and HB 749 did not. SB 470 had an exemption for fitness and recreational sports centers, which was not in the other bills. None of the bills taxed dividends, interest and securities. SB 470 and HB 749 have language exempting insurance commissions and SB 258 did not. All three bills exempt insurance premiums. SB 470 and HB 749 exempt services a corporation provides to an affiliate or subsidiary that is centrally assessed. SB 470 and HB 749 both exempt retail telecommunications services that are subject to the retail telecommunications excise tax. That tax was not in existence when SB 258 was proposed. All three bills exempt gambling. All of the bills taxed sales of light vehicles and provided some sort of exemption for commercial vehicles. SB 258 and HB 749 taxed leases of light vehicles and SB 470 did not. SB 258 had a more general application for leasing of vehicles and SB 470 and HB 749 did not tax leasing of commercial vehicles or heavier vehicles. SB 258 and SB 470 have exemptions for advertising and related services, although the earlier bill only exempted advertising. HB 749 did not have that exemption. SB 258 was the only bill that taxed electricity, natural gas and water, sewage and garbage. The other two bills provided exemptions for those utilities. All three bills exempt unprepared food and ingredients. All three taxed prepared food and food sold through vending machines except where it is part of a residential arrangement or a health care facility. All three bills exempt prescription drugs. SB 258 did not exempt over-the-counter drugs. All three bills exempt therapeutic and prosthetic devices. SB 470 and HB 749 also exempt durable medical equipment and mobility enhancing equipment and SB 258 did not. HB 749 would have applied sales tax to motor fuels for on road use. The other two bills exempted it. All of the three bills exempt off road motor fuels. Regarding personal effects brought into the state by someone moving to the state, the general rule is if something is bought in another state and brought into the state, a use tax is owed on it. All three bills exempted that in the case of someone establishing residence in the state. All three bills provide an exemption for the leases of real estate and for mobile homes. All three provide an exemption for minerals except where used in jewelry or in production of energy that is not for sale. Coal for home use would be taxable but coal for commercial energy production would be exempt. All three bills have similar provisions for exempting industrial and mining inputs and exempt chemicals used in processing ores or petroleum or in acidizing oil wells. All three have an exemption for ingredients or components used in manufacturing. All three have an exemption for mining or oil field equipment or property that had to be abandoned in place. SB 258 and SB 470 provided an exemption for electricity that is used in reducing or refining ores where HB 749 did not. Other industrial and mining inputs are taxed. Mining, manufacturing and processing services were exempted under SB 258 and there is not similar language in the other two bills. All three bills would have taxed construction materials but not the final building except that HB 749 contained an exemption for construction materials that would be incorporated in commercial or public construction. All three bills provide an exemption for sale of mobile homes provided they are permanently attached to a foundation. SB 258 exempted newspapers, magazines and books. The other two bills did not. SB 258 also provided a specific exemption for day care but the other two bills did not. All three bills provide specific exemptions for sales by the federal government, federal agencies, state government, local government, Indian Tribes, and foreign governments. SB 470 and HB 749 exempted sales by government owned utilities and SB 258 did not. All three bills provided exemptions for isolated or occasional sales by persons not engaged in business. This exempts garage sales and non-continuous charity fundraisers. SB 258 and SB 470 taxed isolated or occasional sales of motor vehicles under 12,000 GVW or under. HB 749 did not. All three bills have exemptions for sales by agricultural producers. ***(Tape 5, Side A)*** HB 749 had a more general exemption for other non-retail sales by agricultural producers that wasn't in the other two bills. All three bills have exemptions for purchases by federal, state and local governments, Indian Tribes and foreign governments. All three bills also contain an exemption for food purchased under WIC. All three bills exempt purchases by agricultural producers and an exemption for a number of agricultural inputs. SB 470 and HB 749 also had an exemption for services related to those inputs. SB 258 did not have an exemption for agricultural implements and equipment. HB 749 had a more general exemption for purchases for the exclusive use in an agricultural operation. Vendor allowances are a part of the taxes collected by the merchant that the merchant is allowed to retain to compensate them for collecting the tax. SB 258 allowed for 1.5%, SB 470 allowed 5% of the first $100 per period and 0.5% over $100 collected during a reporting period. HB 749 had a 1.5% allowance for monthly filers and 5% for quarterly filers. All of the bills also had a cap on the vendor allowances of $50 for monthly filers and $150 for smaller vendors who file quarterly.

<u>Questions from the committee</u>

Rep. Peterson asked about the total revenue generated from each of the three bills. **Mr. Dodds** had not done that for SB 258. He advised there are fiscal notes for the two bills from the last session. **Rep. Peterson** said he was curious about the revenue based on the exemptions.

Ms. Whittinghill asked about industrial and mining inputs. She didn't remember those being specifically taxable in HB 749. **Mr. Dodds** advised the other two bills had specific language exempting those whereas HB 749 did not. **Ms. Whittinghill** thought it was a broader exemption in HB 749.

Rep. Peterson advised they exempted utilities and fuel in the final bill.

Sen. Perry said chemicals used in processing ores and petroleum would be exempt under the three bills but other industrial and mining inputs would be taxed under all three bills. He wondered about the logic and what was the target. **Mr. Dodds** indicated in terms of the table the last line is there because another bill last session had a broader exemption. In the overall language of the bills, one section said all sales are presumed to be taxable unless specifically exempted by another section. A distinction was made in all three bills that the parts going into manufacturing processes were exempt but the equipment used in the process would not be exempt. In mining and oil field production, items left in place are a necessary part of extracting minerals and can't be reused. Chemicals are used up and are not part of the final product. **Sen. Perry** advised chemicals used in processing ores would be exempt but chemicals, cleaning agents, coolants, etc., in manufacturing would be taxed. He pointed out economic development and growth of businesses is being encouraged and he thought fairness across the board was important. Processes used in manufacturing are just as vital to production as chemicals used in processing ores, etc. **Sen. Bales** advised that when or if they start working on a sales tax there will be details and exclusions to look at and work with.

Ms. Whittinghill asked about natural resource taxation and whether the legislation that changed the distribution scheme assumed the 101 mills back to the state. **Mr. Dodds** replied HB 748 in the last session converted the oil and gas tax distribution to fixed percentages. The role for mill levies is no longer in the law. The intent of the bill was to leave the distribution as it was under the prior law.

Gordon Morris, Executive Director, Montana Association of Counties (MACo), presented a briefing paper from the **MACo** Tax and Finance Budget Committee. The **MACo** bill would have generated $524 million and the **Peterson** bill revenue estimate was $480 million. There was no fiscal note done on SB 470 but it was understood the revenue was comparable to that generated from HB 749. **MACo** feels a sales tax is doable and that the voters would support it. They don't necessarily think it should go to the voters. They have done surveys and conducted interviews, etc., regarding sales tax proposals. Any proposal must be revenue neutral or better. It is estimated 8-12% of any revenue collected from the sales tax will come from tourists. Revenue neutrality has to be measured in terms of impacts directly on Montanans. The tourist dollar can be viewed as new revenue. If the sales tax raises $500 million, tourism will pay $50 million of that and Montanans will pay $450 million. That is a standard used across the country. The proposal must provide significant funding for education and property taxes must be significantly reduced. The **MACo** bill reduced property taxes significantly and would have funded education at an all time high of eighty percent of base. Currently the base is being funded at about 40%. He thought that unacceptable. There is the potential of a lawsuit, he contended. There has to be a mechanism in place to insure against "tax creep". That is achievable given the four percent constitutional cap on the sales tax. Broadening a narrow tax would increase revenue. The **MACo** bill proposed remaining property taxes would be capped within an allowable growth mechanism. The property tax would be reserved for local governments. Schools would be funded from the sales tax and the state would have the combination of the sales tax and income tax. He pointed out any sales tax must be based on a very broad and general application of goods and services. The broader the more progressive; the narrower the more regressive the tax is. Exemptions would be limited to non-prepared food, health services and prescription drugs. Any tax reform proposal should take into account the need to address certain elements he felt should be addressed by the committee. Income tax restructuring should be achieved. The capital gains tax should be restructured. He favored a flat tax. There should be a reduction or elimination of education funding from property taxes. Over-base budgeting has to be based upon local levies. There has to be a low income tax credit for the sales tax. The poverty level needs to be recognized and the schedule should be as progressive as possible. Those that are paying the most percentage-wise out of their personal income would get the most back as opposed to those paying the least. There should be a significant reduction in residential property taxes. He liked the idea of a 65% exemption of the first $50,000. Exempting the first $50,000 leaves some property off the tax rolls in their entirety. They believe everybody should be paying something. There should be a like adjustment for commercial property. The business equipment tax is hard to collect and should be eliminated. It should be phased out and paid for rather than just phased out which is what happens with the trigger mechanism. He thought consideration should be given to an increase in both the telephone excise tax and generation taxes. The current tax on generation is .0002 cents per kilowatt. That generates about $3 million a year and most of the energy is going to Portland and Seattle, etc. Since 1983, studies of the estimated revenues of a 1% sales tax have demonstrated elasticity no other revenue source even compares to. In 1975 statewide taxable value of one mill was $1,350,000 and the total property tax collection was $266 million. In 1985, the value of a mill was $2.470 million. Every mill levy for the 6 mill University levy generates $2.3 million. Total tax bill in 1985 was $572 million. He reminded the committee that in 1986, I-105 was passed and from 1986 there was a property tax freeze and the property tax bill went down as a result. That is the same period of time the legislature had to come back into special session and address the under-funded school lawsuit. As a result of the threat of a lawsuit, in 1995 the value of the mill was $1.8 million and $739 million of property taxes was being collected. That was the 40 mill school assessment by way of the under-funded lawsuit. In 2002, the value of the mill was $1.718 million and the bill was $826 million. The money is going to education. The situation needs correction, according to **Mr. Morris.**

Rep. Peterson hoped the **MACo** committee would discuss the pros and cons of eliminating property taxes versus 100% refundable property taxes if a Montana tax return is filed. Non residents would pay property tax. ***(Tape 5, Side B)*** **Mr. Morris** advised tax refundable credits would be designed so a non-tax filer wouldn't get it. He expressed concern about the cost. **Rep. Peterson** clarified if a refundable credit is provided on the tax return it costs much less than eliminating property taxes altogether. **Mr. Morris** indicated he would recommend that approach.

Rep. Lake asked if the 101 mills were eliminated, taking the state out of the property tax business, what would prevent the counties from taxing property at that level. **Mr. Morris** advised laws that apply to local governments cap what local government can generate directly tied to a percentage of the growth. That is determined by the **Department of Revenue** based upon a rolling three-year average. County governments would not be able to grab the 101 mills. The other fear would be the legislature would grab the 101 mills in the future and the taxpayers would need some assurance. **Rep. Lake** acknowledged those laws are in place, but counties can go to their voters to get a levy passed to pull that number back up. **Mr. Morris** agreed they can go to the voters and thought the link between the voters and the elected officials is fair and voters can approve or disapprove of something at the polls.

Mr. Driscoll asked about the constitutional amendment to stop “tax creep”. **Mr. Morris** advised the constitutional cap could be viewed as addressing the “creep” from the standpoint of the sales tax. **Mr. Driscoll** advised if it was put in the constitution that eliminated property taxes could only be reinstated by the will of the people, the legislature could repeal that law. He wondered what assurances there were that once the constitution eliminated the 101 mills, the voters would not kill the sales tax. **Mr. Morris** commented the sales tax bill that was killed wasn’t a good bill. **Mr. Driscoll** didn’t think it mattered if it was a good or bad bill, the people could vote that the state may not impose the 101 mills and then kill the sales tax. **Mr. Morris** advised the only way to reinstate the eliminated property tax in the **MACo** bill was to put it to a vote. He would like to see it in statute.

Sen. Ellingson commented there are a lot of values in the proposal and he liked some and didn’t like some. He thought some were conflicting. He agreed with finding significant funding for education. He disagreed with the idea of revenue neutrality. The only new revenue coming in is approximately $60 million. The remaining revenue would be used for income tax restructuring, capital gains tax restructuring, elimination of the business equipment tax, comstead and homestead exemptions, income tax credits, etc. He wondered how much would be put into these categories and how much more would be used to fund education. Funding for education is currently inadequate. They need to make sure there is money for education and it doesn’t all go to rearrange the deck chairs on the Titanic. **Mr. Morris** advised some elements have changed since 1997. In 1997 their proposal talked about total revenue excluding vendor allowances and delinquencies of $547 million. The total tax relief was $562 million. It was better than revenue neutral. They were able to do that and create a revenue source that is elastic, unlike the property tax. The mill has lost value and the only way to get the needed revenue is to increase mills to get the same number of dollars. **Sen. Ellingson** contended if they are generating $560 million in revenue and providing $580 million in tax relief, there is no new money for schools. **Mr. Morris** replied the tourism dollar is estimated at $58 million in new revenue to offset the cost of the program.

- break 3:00 p.m. -
- reconvene 3:15 p.m. –

Sen. Bales requested a budget report in order to consider the work plan of the committee and Mr. Finch offered to provide a full update at the next meeting and what it would require in order to stick to the work plan.

Mr. Finch discussed and defined the terms “regressive” and “progressive**.** The terms fall under the general guiding principle of taxation that addresses fairness and equity in taxation. The benefits received principle is those who enjoy the benefits of government services should pay for those services in proportion to the benefits received. Examples included highway toll-booths and gas taxes which pay for highways. The ability to pay principle asserts that tax burdens should be related to an individual's ability to pay based on economic well-being. Tax burdens are measured by the ratio of tax liability to total income. The ability to pay involves horizontal and vertical equity. Most income taxes and flat taxes incorporate the ability to pay principle. Vertical equity is measured in terms of whether a tax is progressive, proportional or regressive. A tax is considered to be progressive if the proportion of income paid in tax increases as income increases. A tax is regressive if the proportion of income paid in taxes decreases as income increases. A tax is proportional if the proportion of income paid in tax is constant as income increases. Montana's individual income tax is considered to be progressive. **Sen. Harrington** asked if the figures were from after SB 407 was passed. **Mr. Finch** indicated no. **Sen. Harrington** commented the basic rate was not 11%, but 6.7%. **Mr. Finch** replied the effective average rate on high income households was around 6.7%. The marginal rate on high income households is 11%. High income households in Montana are paying taxes at the rate of 11% at the margin—on their next dollar of income. High income households also get the benefit of all the tax breaks below 11%. These taxpayers are also eligible for personal exemptions and itemized deductions. Taxable income is on a portion of total household income. On average they pay around 6.7% of their income in total compared to their total income. On the last dollar of income, they are paying 11 cents out of every dollar. Regarding property taxes, **Mr. Finch** determined the property tax is highly regressive on the low end and then slightly regressive after that. There are some weaknesses in measuring regressivity or progressivity with respect to what a person's income or consumption is at a particular point in time. ***(Tape 6, Side A)*** **Sen. Bales** wondered if it would be worthwhile to look at property tax regressivity prior to the stock market losses two years ago. **Mr. Finch** indicated thought it would be somewhat the same type of look. Stock market losses are capped at $3000 a year. Other losses are allowed to be taken in full.

In answer to a question by **Mr. Driscoll** about depreciation of a business, **Mr. Finch** advised depreciation for a business would come under Schedule C Net Business Income. In 2001, the amount of residential property taxes reported on itemized deductions compared to the total amount of residential property taxes levied that year was about 85% of the total. Of the total, 5-10% is being paid by non-residents. The numbers also included the impacts of the low- income property tax assistance program and the credit provided to the elderly under the elderly homeowner renter credit program.

Rep. Peterson asked if a flat tax on the income tax schedule would be proportionate or regressive. **Mr. Finch** advised people think the flat tax would be proportionate because there is only one rate. Most flat tax proposals he has seen are progressive. The flat rate applies to taxable income, not total household income. Under most flat tax schemes, people at the low end are not paying taxes. There are large standard deductions, personal exemption amounts, and the tax rate is zero up to $30,000 of income. At $40,000 of income there is a 5% tax on $10,000. There is a progressive tax structure because of personal exemptions and standard deductions that are usually built into those proposals. A flat tax proposal can be provided with effective tax rates that look exactly like the current income tax rate schedule. **Rep. Peterson** said if they were to do a flat tax with a low end personal exemption it could be very progressive and **Mr. Finch** said that was exactly right. It depends on how the deductions and exemptions are structured. Regarding business taxes, there is disagreement on who pays those taxes. There is a difference between the statutory incidence of the tax and the economic incidence of the tax. Statutory incidence refers to who is responsible for collecting and remitting the tax to the state. It is not clear where economic incidence of that tax lies. The incidence of business taxes can either go on the consumers in the form of higher prices, but depending on the market conditions, supply and demand, etc., that tax can be shifted backwards onto labor in the form of reduced wages and benefits or shifted onto producers in the form of lower rates of return on the business. There are no clear and fixed rules in the literature on how business taxes ultimately get distributed. Without knowing that, it is practically impossible to determine whether business taxes are progressive or regressive. Some states assumed 60 % of the sales tax is passed forward to consumers and the rest is paid by business. Regarding the regressivity of sales taxes, in the past it was taken for granted that sales taxes are regressive by nature. That was supported by the fact that high income households tend to save a greater portion of their incomes than do lower income households. Economists refer to this as the marginal propensity to consume. Low-income households tend to spend every dollar. With higher income levels a greater percentage of income is not subject to the sales tax. In the past, the annual income approach was used which supported the notion that the sales tax was regressive. Recently, studies have used the lifetime incidence approach. When that is done the regressivity of the sales tax is less.

Rep. Carney contended the young are paying more in taxes when they can least afford it and older people when they have more money or consume less are paying less taxes. She didn’t see how that mitigates the regressivity. **Mr. Finch** clarified retired people have savings and are not worried about their consumption. They can spend, travel, etc, and pay sales tax associated with that. They are spending deferred income that is not being counted in those years as income. **Rep. Carney** noted there are people in her district that make $15,000 their whole life long. They would pay more with a sales tax than income tax. She wondered if there is a percentage associated with people that might change over a lifetime versus people that stay static. **Mr. Finch** said if everyone who started off their lives made the same income, a sales tax would be regressive. For the majority of people that doesn’t hold true. Evidence has not indicated sales taxes are not regressive, but when considered from the lifetime incidence approach, sales taxes today look a lot less regressive than they used to look.

Mr. Watts asked about exemptions and their effect. **Mr. Finch** continued there are several policy options to reduce the regressivity of the general retail sales tax and perhaps eliminate the regressive aspect of the tax altogether. These include exempting food purchases, including a larger number of services in the tax base, and providing low income households with refundable credit. The degree of progressivity and regressivity can be measured by using the Suits index.

Rep. Peterson asked if they could use the index to graph different scenarios of a sales tax with varying degrees of exemptions and low- income credit and do it in such a way that they could see where the lines cross between regressivity and progressivity. **Mr. Finch** advised the index is not a line, it is a single point number. It tells relative progressivity or regressivity. Since there is no sales tax in Montana it is difficult to associate sales taxes with incomes and households in Montana. They have never completed a study here that a sales tax will be regressive or progressive. The Consumer Expenditure Survey by the Bureau of Labor Statistics provides information by state of the amount being purchased by households of various income levels for broad categories of goods and services. They have used that in the past to take a look at comprehensive reform proposals that would provide for a sales tax while decreasing property and income taxes. Based on that data, they might be able to determine whether one proposal was more progressive than another.

Ms. Whittinghill asked if they have done that previously. **Mr. Finch** said the last time progressivity indexes were part of the discussion was the early 1990s.

Sen. Bales determined that the review of past Montana tax study committees would need to be read later by individual members. He asked for an update on the inventory of state and local government taxes. **Mr. Dodds** advised the legislation that created this committee called for the creation of an inventory of taxes. **Ms. Whittinghill** had also asked him to look at fees. He gathered the dollar amounts for all state and local taxes and fees for the last year available. He started going through the taxes and looking at how they are allocated. They were considering lumping fees into broad categories. **Mr. Finch** said there were 607 distinct state fees. **Mr. Dodds** indicated the local list is just as long. **Sen. Bales** asked if the subcommittee would like to address that issue. **Ms. Whittinghill** said the Montana Taxpayer Association recently started to look at fees. She favored looking at broad categories to see the impact. She though it would be nice to see the increase in the use of and reliance on fees. **Mr. Driscoll** wondered if it would be possible to look at how much fees are assessed against property by local governments. He wondered if the state assesses any fees against property. **Mr. Finch** replied there is a per capita livestock fee. ***(Tape 6, Side B)***

Rep. Lake asked how many of the fees that are listed fund a program. He wondered how much revenue the state receives over and above the cost of running programs where fees are established and whether they are considered a revenue source or maintenance of operations. **Mr. Dodds** advised in most cases they don't go into the general fund; they go into special revenue accounts. **Rep. Lake** wondered if any excess fees could be pulled and used for other things. **Mr. Dodds** thought broad categories would be workable. **Sen. Bales** asked the subcommittee to come up with a form that makes sense.

Sen. Perry reported the draft work plan by the subcommittee was completed. **Mr. Morrison** advised he looked at work plans of other committees. The plan included the tasks listed in the legislation and the timeline for completing those tasks. **Rep. Peterson** commented it was a good plan and requires the committee meet every month through the spring. He wondered if their budget would allow a series of listening sessions next summer to take public input on what the committee's recommendation might be. **Mr. Finch** indicated the shared budget of this committee and the Property Tax Reappraisal Committee is $60,000. The cost of a meeting is about $3000.

Rep. Cohenour recommended the committee not meet in December. Paperwork could be distributed by email and the questions could be brought to the meeting in January. **Sen. Bales** said he spoke to **Rep. Ron Devlin, Chair, Property Tax Reappraisal Committee** who thought the two committees should meet together within the first two weeks in January. **Sen. Bales** thought a two-day meeting in January would save transportation costs. **Sen. Harrington** expressed concern with running out of time. **Sen. Bales** didn't think the other committee would use $30,000 for their portion of the budget. He thought they would meet six or seven times. **Sen. Perry** said the first three meetings were organizational. They have had public input and review from the department which were time consuming. They will be coming prepared for the meetings and there will be less time consuming items on the agenda.

Rep. Lake thought they would be doing themselves a disservice by putting things off now and thinking they would be finished by June in order to present recommendations to the public. He would like to see them running ahead of schedule. The sooner their recommendation is ready, the better it will be for getting public acceptance.

Sen. Ellingson indicated he liked the list of tasks, but a priority should be given to deciding on a process for evaluating tax expenditures. Several tax expenditures that are already on the books need to be discussed—the phase-out of the business equipment tax and the tax credits to those with capital gains taxes. They have to be considered as revenue projections come in. He asked those issues not be forgotten as they continue the work of the committee. He didn't have a problem with the committee's moving toward a sales tax, but maintained there are other tax alternatives they should consider—the "big box" tax, gambling tax, etc.

Rep. Peterson recommended they press on and try to stay on schedule. Otherwise they would be looking at a two-day meeting in January. The schedule in January would be somewhat limited as they will be meeting jointly with the Property Tax Reappraisal Committee. **Sen. Bales** mentioned the possibility of a day and a half meeting. He said he would entertain a motion to approve the timeline. The timeline could be amended as they go forward. **Sen. Perry** so moved and **Sen. Harrington** seconded the motion. The motion carried.

The committee continued discussing the scheduling of the next meetings. The committee will meet jointly with the **Property Tax Reappraisal Committee** and separately on Monday, January 12th and Tuesday, January 13th in Room 317 of the Capitol.

Sen. Bales addressed the continuing work of the staff including the list on existing taxes, and the report from **Mr. Standaert** and **Mr. Martin** on what is happening in other states. The review of past Montana tax study committees would be read by individual committee members. He addressed the agenda for the next meeting. He requested an update on the work of the other committee from the staff of that committee. **Mr. Finch** indicated **Delores Cooney, Department of Revenue,** and **Randy Wilke, Department of Revenue** could provide an update. **Sen. Perry** thought an update would be appropriate in January.

Mr. Watts thought a discussion was necessary on the federal deductibility issue. He was willing to work with the department on that issue. **Sen. Bales** indicated that should be on the December agenda. ***(Tape 7, Side A)*** **Rep. Lake** said he would like a recap of public testimony in December. **Ms. Whittinghill** asked the department to review mineral and severance taxes being lumped in with property taxes and whether that alters the picture. Wyoming could be significant in that regard. **Sen. Bales** advised one of the tasks of the committee is to set criteria for evaluating existing taxes. He didn't think they had done that. He wondered by what process they would develop criteria and at what point in time they would do that. **Rep. Cohenour** thought that was the impetus for the initial discussion on regressivity and progressivity and the discussion today. She thought the basis was that of a taxpayer and looking at regressivity and progressivity. She thought they would have to wait until they have proposals. **Sen. Bales** thought they agreed to use the seven guiding principles of taxation for evaluation. He wondered what it would entail to evaluate all of the different taxes with those seven criteria. He asked the committee if that is what their charge is. **Mr. Watts** thought they were going to have to justify their actions and he thought one way to do that was with the seven criteria.

Sen. Perry noted the charts presented on progressivity and regressivity were created prior to SB 407. He thought before they could come to consensus they need to know the impact of SB 407. He contended there is no impact—it is not a tax cut. Once the federal deductibility is eliminated, the curve will move back up. He wanted to see that addressed and wanted to see the impact of federal taxes. He thought that would be of help later in the spring as they try to achieve consensus. **Mr. Driscoll** asked if there is a definition of "wealthy". $50,000 a year is twice the average income. He didn't consider that wealthy but maybe it is to the taxman. **Rep. Cohenour** thought they would have to look at specifics as they come up. **Sen. Perry** indicated his intent was they overcome disagreements, erroneous assumptions and differences in ideologies with facts early on. **Sen. Bales** said the guiding principles of taxation were simplicity, accountability, economic neutrality, equity, complimentary, balance and stability. He didn't know if those were all the things they wanted to evaluate each tax on and thought they need to develop criteria. **Rep. Peterson** said some of this is very subjective but he thought it worth having a discussion. He agreed with **Sen. Perry** of the need to look at SB 407 in more detail. He hoped as the discussion progresses they will reach some agreement; he didn't think they would have a complete consensus. **Sen. Bales** said the criteria issue could be on the agenda for the next meeting. **Rep. Cohenour** thought the reason for the subcommittee was to help focus that down. She thought it difficult to discuss and form criteria if something is not looked at in a specific context. The reason it was suggested it be a specific taxpayer was so they could focus in on whether it was a good tax, fair, etc. Even using the guiding principles involves personal judgments. She didn't think bringing facts and figures forward would change a lot of minds. **Sen. Bales** thought a "taxpayer" is anybody that pays tax whether an individual, corporation, etc. He thought all taxes could be judged by a set of criteria and he wanted the committee to develop criteria for judging taxes, i.e. is it progressive or regressive, equitable, fair across the board, etc. He asked **Mr. Finch** if individual members could email ideas for criteria to be discussed at the next meeting. He thought **Mr. Finch** was probably familiar with other studies on evaluating taxes. **Mr. Finch** thought the guiding principles are the criteria that should be used to evaluate the appropriateness of any tax structure. Everything he had ever seen referred to those established principles by NCSL.

Rep. Lake thought every tax has to stand on its own. Some taxes are tooled to the user such as the fuel tax. A tax for education could not be run on the same theory as only those with children would be paying. The criteria have to be the same, but there will be some progressivity and some regressivity. He thought the guiding principles should be used to decide whether taxes are fair or not fair. **Mr. Watts** agreed with **Mr. Finch** regarding the guiding principles. **Sen. Bales** asked if they would use those to evaluate existing taxes. **Mr. Watts** said the guiding principles would guide them in preparing alternatives. The principles allow making comparisons between alternatives. **Mr. Finch** thought when they have agreed upon a final recommendation they could compare that to the current tax structure using those guidelines. **Sen. Bales** asked if that is the charge written in the law. He thought the law said they would evaluate current taxes. **Ms. Whittinghill** said the letter they first received said they would "provide an analysis that evaluates existing taxes in terms of their adequacy, efficiency, fairness, impact on economic behavior, cost of administration and compliance, etc., which are the guiding principles. **Sen. Ellingson** thought if they undertake the task of evaluating every tax on the books using those principles, they are biting off more than they can chew. He thought the committee members should be polled and a decision made on which ones to focus on and consider for tax reform purposes and apply it that way. **Mr. Morrison** agreed with that in terms of staff time. **Rep. Cohenour** didn't think they would look at it the same way, but they need to look at it with the principles in the background as their primary focus. **Rep. Lake** said he was not interested in looking at fees but wondered how large the inventory of taxes is. **Mr. Dodds** advised it is on one page. Additional information would make the report longer. **Rep. Lake** requested a copy be emailed to the committee along with a short version of where the revenue goes before the next meeting. **Sen. Bales** thought the consensus of the committee was to use the guiding principles. They may evaluate the entire system and then any proposed changes to that system. Members would start to put forward suggestions at the December meeting.

Sen. Bales adjourned the meeting at 5:00 p.m.

Minutes read and approved by: ____

Senator Keith Bales, Presiding Officer Date